REMARKS OF TREASURER DEBORAH B. GOLDBERG

Consensus Revenue Hearing
State House Room A-1
State House, Boston, MA 02133
Monday, December 5, 2016

As prepared for delivery:

Secretary Lepore, Chairwoman Spilka, Chairman Dempsey, and members of the Committee – thank you for the opportunity to testify this morning.

I always look forward to meeting with you and having a candid conversation about the state's revenue projections and fiscal outlook.

Budget and Stabilization Fund

I will begin today – as I have in years past – by emphasizing how important it is that we address our stabilization fund in FY18.

The last time we met for this hearing, Standard & Poor's had just lowered our economic outlook to negative on November 23, 2015, and they cautioned us specifically about the depletion of those reserves. A year later, although the rating remains the same, the message from S&P is more direct about what needs to be done to avoid a rating change.

Three weeks ago, S&P affirmed their rating for our General Obligation bonds as AA+ with a negative outlook. Although they commended our policy of "setting above-trend capital gains tax during good times" as a "positive management tool," they added an additional warning. The "decision to suspend those transfers shortly after adopting them, despite positive economic performance, is viewed negatively from a credit standpoint."[1]

They warned that "continued structural imbalance and reduction to our reserves" may result in consequences in the not too distant future. They stated, "In our view, continued structural imbalance and reduction of reserves could contribute to a downgrade over the next few months to a year if we believe that the financial flexibility is impaired - especially during a period of positive economic growth - and leaves the state less equipped to deal with the next economic downturn."

I take that risk very seriously, and we must work together collectively to respond in a way that will best serve Massachusetts.

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[1] Standard & Poor's, "Massachusetts; Appropriations, CP; General Obligation; General Obligation Equivalent Security; Joint Criteria; Sales Tax," (November 22, 2016).

I am fully aware that we are faced with making very difficult choices. Unfortunately, we cannot afford to wait any longer to act. If we do not progressively replenish our reserves now, we will pay the price, and any downgrade will impact nearly everything we do.

Pension Fund Assumed Rate of Return

The first area of Treasury I would like to discuss today is the pension fund. Its balance at the end of October was $62.2 billion. In the last fiscal year, the fund earned a return of 2.3 percent, which placed it within the top 15 percent of its peers. This success in a volatile investment environment, is largely based on timely investment in long-term treasury securities and alternative investments; for example, for FY 2016, private equity returned 12.15 percent, gross of fees, and real estate earned 12.21 percent, gross of fees.

S&P recognized that our decision to lower the assumed rate of return from 7.75 percent to 7.5 percent put us on par with the national average. They observed that we are taking conservative, but prudent steps and acting realistically, given our unfunded liability.

But they also noted that required contributions cannot decrease, stating that future underfunding of the annual contribution would be viewed as “a potential structural imbalance” and that underfunding or weak investment returns also may result in a downgrade of our bond rating.

That is why, when it comes to the next three-year pension funding schedule, I would recommend that the state maintain its commitment to continuing the annual contribution of 10 percent.

Despite strong performances in recent years, we are well aware of the fact that we are heading into an uncertain economic environment. We believe the pension fund is positioned well from a risk perspective, but we must take actions to maintain and preserve the fund as we also seek new opportunities for growth.

It will require disciplined fiscal management and prudent investment standards if we want to meet our retirement obligations now and into the future.

Executive Director Joe Connarton and Actuary Jim Lamenzo from the Public Employee Retirement Administration Committee (PERAC), have joined me at the table this morning. They can answer questions you may have about the assumed rate of return and provide feedback about trends around the country and among comparable pension funds.

Unclaimed Property

Turning to our Unclaimed Property Division, I am pleased to report it continues to deliver exemplary service to Massachusetts residents. In FY 2016, we returned nearly $113.8 million in cash, stock, and mutual funds to its rightful owners.

You might remember in FY 2015, the Unclaimed Property Division reverted more than $80.5 million to the General Fund. But in FY 2016, we did even better than that, turning over nearly $95 million to the general fund and additionally $27 million to the Stabilization Fund.

This deposit into the stabilization fund was a first and occurred because we triggered the requirements of Chapter 29, Section 5H of General Laws, which states that 75 percent of the growth in unclaimed property revenue – when it exceeds the amount collected the previous fiscal year – goes to the rainy day fund. This is an example of one of the management tools that S&P referenced in their rating narrative.

For FY 2017, we had provided an initial estimate of transferring $81 million to the General Fund, and we anticipate meeting that projection. With respect to FY 2018, we expect to transfer approximately $126 million. This increase is due to a large liquidation of stock and mutual funds that will take place this upcoming summer.

If our projection is accurate, we would again be able to deposit 75 percent of this revenue growth above the previous year into the stabilization fund. I am sure we would all agree that this would be a welcome outcome.

Massachusetts State Lottery

Our State Lottery also has been a reliable and lucrative form of revenue for many years. It is the strongest in the nation, and the primary source of unrestricted local aid for all 351 of our cities and towns – and we intend to keep it that way.

In FY 2016, the Lottery's net profit amounted to $989.4 million, a 0.4 percent increase over FY 2015. And for the second straight year, we topped the $5 billion mark with a total of $5.2 billion in sales. I should note our numbers were bolstered by a huge, multistate Powerball game last winter that added about $27 million in profits to our bottom line.

I would like to acknowledge that our hardworking lottery team put up another record performance. However, I also cannot ignore, as you just heard, that those record numbers come by a very thin margin, even less than inflation, and year-over-year increases are actually beginning to flatten. In the very near future, we may see decreases if we do not start pursuing new and innovative avenues for growth.

The number that tends to matter most to our customers, and which drives them to continue playing, is that 73.41 percent of revenue was returned to them in the form of prize payouts last year. And our partners who make it all possible – our retailers and small business owners – earned close to $300 million in commissions and bonuses, compared to $286 million in FY 2015.

Meanwhile, and I want to emphasize this, we spent $102.7 million on administrative costs in FY 2016, which represents only about 2 percent of our revenues, and continues to be the lowest ratio of any lottery in the country.

Our strongest performing games – instant tickets and Keno – continue to drive our sales numbers. Together, they contributed to more than 86 percent of our entire sales in FY 2016, as instant tickets made up 69.1 percent and Keno added another 17.3 percent.

Now, you may have read a rosy story in the *Boston Globe* recently about Keno's "abiding success" in a casino era. It's true that we are leading the nation for Keno sales, and many longtime customers continue to play the game in restaurants and other locations across the Commonwealth. However, the Keno market is virtually saturated, which is why we have begun preparing for a period of stagnation.

And the reality is our instant tickets are already experiencing a slump; our Executive Director even projected they could be down as much as 2 percent or more this year. I encourage you to read the recent *State House News Service* story on this subject, which paints a much clearer picture of the challenges and opportunities we face. And if we experience a difficult winter this year, the final numbers could be even worse if customers are less willing to trek outside to play over the next few months.

Between the impending arrival of casinos, increasing competition from daily fantasy sports, the overall shift to online versus point-of-sale transactions, and our aging lottery demographic, we have no choice but to pursue new solutions. We must focus on making the Lottery more appealing to Millennials, while we continue to offer games that our loyal customers know, trust and enjoy.

That is why I filed a bill that would allow us to pursue online lottery safely in Massachusetts. I view our Lottery as a mission-driven business, not a profit-driven business.

Moving onto smartphone apps and online will protect our long-term growth and allow us to continue delivering the local aid that cities and towns need. At the same time, we can continue to uphold consumer protections and provide fair payouts to our players.

Similar legislation filed last session ultimately was unsuccessful. This next time around, I hope we will embrace new technology that will allow our Lottery to move forward in a way that will only benefit the needs within our communities.

For the remainder of FY 2017, we believe we are on track to return about $968 million in profit as projected. We have had success by changing out Jackpot Poker for our All or Nothing game this year. Customers responded well to the switch, and there has been talk about possibly rotating these types of games more frequently in the future to sustain interest.

Looking ahead to FY 2018, we anticipate we will return about $965 million in net profit to the Commonwealth, taking into account that there will be a large prize accrual next year related to the Billion Dollar Blockbuster Game, with an estimated cost of $22.6 million. This is assuming level funding of Lottery operations, including $4 million in advertising.

I remain proud that our Lottery is the most profitable and efficient in the country, but we must be realistic about the challenges we face. It is incumbent upon all of us to pay close attention to the market in order to improve our current games and develop new offerings.

If we fail to do so, local leaders will need to start thinking about how to trim their budgets based on decreases to their local aid in the coming years.

ABCC

The Alcoholic Beverages Control Commission (ABCC), was able to generate $7.4 million in revenue for the Commonwealth in FY 2016. This represents an increase of 61.5 percent over the previous fiscal year, due in large part to a record, $2.6 million settlement.

The majority of ABCC revenue stems from license applications, including the issuance of new licenses, new license types, fees and fines, as well as renewals. In calendar year 2015, the Commission issued 26,000 licenses, certificates and permits for alcoholic beverages and processed 32,000 license transactions. Each of these represent increases over previous years.

The ABCC works with other state agencies to generate other additional revenue. For instance, in FY 2016, they worked with the Department of Unemployment Assistance, the Department of Industrial Accidents, the Lottery, and the Department of Revenue to collect $11.8 million in outstanding taxes, fines and other debt owed to the Commonwealth.

The Commission anticipates they will collect $4.3 million in FY 2017, and projects the same figure for FY 2018. This work is accomplished with a budget of $2.34 million, 26 employees, and the fifth lowest ratio of enforcement agents to licensees in the country.

It is clear that the ABCC provides significant value to our Commonwealth. It supports businesses that create economic growth, while generating revenue for the state. However, it will require additional resources if we want to continue supporting local communities by balancing the high volume of licenses, while helping to protect Massachusetts residents from alcohol-related injuries and incidents.

Marijuana

Before closing, I would like to comment on recreational marijuana. As you know, my office gained the Cannabis Control Commission after Massachusetts residents voted in favor of legalization in November. Right now, the industry is still in its infant stages; we are required to have a regulatory agency in place by March, and we do not expect the industry to get fully underway until midway through FY 2018.

While the new law does enable us to issue up to 75 licenses each for retail, production, and cultivation in our state, we do not anticipate their respective fees will represent significant revenue for the Commonwealth this coming fiscal year.

Question 4 created a Marijuana Regulation Fund to support administration and enforcement activities, first and foremost. All of the expenses associated with those operations are still fairly uncertain at this point, especially since we will be creating a new agency from scratch, whereas other states expanded existing agencies, boards, or commissions. And by law, we are not expected to have our own Cannabis Control Commission in place for another three months.

However, my office did publish a Request for Qualifications that will allow us to project at least what an electronic tracking and licensing system might cost the state.

I have repeatedly vocalized my concerns about the 3.75 percent excise tax rate that was included in the ballot question. It pales in comparison to Washington State's 37 percent and Colorado's 29 percent rate, among others.

We know from our discussions that Washington State spent approximately $5 million in startup costs, however they put cannabis into an existing alcoholic beverages agency. By the way, that agency already had 100 investigators; we have 15 at the ABCC, with a similar population.

At the same time, Colorado's initial revenues received from licensing prior to launching its marijuana industry in January 2014 were only $1.9 million, while their Marijuana Enforcement Division spent about $5.1 million on regulation and enforcement in the first year.[2]

With that being said, it's likely that our new recreational marijuana industry will not yield any significant support for the Commonwealth in FY 2018. In fact, I anticipate returning before you to request funding in order for us to carry out all of the responsibilities involved with this new endeavor.

Conclusion

Thank you again for allowing me to participate in this hearing, and for your time. I do not mean to sound like gloom and doom about the challenges that lie ahead. What I seek to do, is be realistic in a challenging environment, and also point out opportunities that we must consider in order to respond to changing conditions.

I look forward to many more conversations about these issues in the coming weeks and months, and working together as you develop your budgets.

Now, my colleagues and I are happy to answer any questions.

[2]The Tax Foundation, "Taxing Marijuana: the Washington and Colorado Experience," (August 25, 2014) http://taxfoundation.org/article/taxing-marijuana-washington-and-colorado-experience; Council on Responsible Cannabis Regulation, "Marijuana Revenue and the Cost of Regulation in Colorado" (August 8, 2016) https://www.crcr.org/wp-content/uploads/2016/04/CO-MJ-Revenue-and-Costs_080716.pdf.